STATE OF NEW YORK

DIVISION OF TAX APPEALS

In the Matter of the Petition	:	
of	:	
NEW INTRIGUE JEWELERS, INC.	:	DETERMINATION DTA NO. 823770
for Revision of a Determination or for Refund of Sales and Use Taxes under Articles 28 and 29 of the Tax Law for the Period December 1, 2005 through August 31, 2008.	:	

Petitioner, New Intrigue Jewelers, Inc., filed a petition for revision of a determination or for refund of sales and use taxes under Articles 28 and 29 of the Tax Law for the period December 1, 2005 through August 31, 2008.

A hearing was held before Thomas C. Sacca, Administrative Law Judge, at the offices of the Division of Tax Appeals, 1384 Broadway, New York, New York, on May 3, 2012, at 10:00 A.M., with all briefs to be submitted by September 14, 2012, which date commenced the six-month period for issuance of this determination. Petitioner appeared by Lawrence R. Cole, CPA. The Division of Taxation appeared by Mark F. Volk, Esq. (Osborne K. Jack, Esq., of counsel).

ISSUE

I. Whether the audit methodology utilized by the Division of Taxation in its audit of New Intrigue Jewelers, Inc., had a rational basis and was reasonably calculated to reflect the taxes due.

II. Whether the Division of Taxation may issue a notice of determination where it has previously issued and canceled a notice of determination for the same periods.

III. Whether penalties asserted against petitioner should be abated.

FINDINGS OF FACT

1. Petitioner, New Intrigue Jewelers, Inc., operated a kiosk in the Roosevelt Field Mall located in Garden City, New York, selling jewelry. Mr. Muhammad Abbasi was the president of petitioner.

2. On July 3, 2007, July 25, 2007, September 28, 2007 and October 16, 2007, the Division of Taxation (Division) sent letters to petitioner stating that the business's sales and use tax records had been scheduled for a field audit for the period September 1, 2004 through May 31, 2007. On May 8, 2008, the Division issued to petitioner a Notice of Determination indicating sales and use tax due of $285,088.82, plus penalty and interest for the period September 1, 2004 through May 31, 2007. The notice was based on an audit methodology that had been employed by the Division in an audit of petitioner for an earlier period.

3. In ***Matter of Abbasi*** (Tax Appeals Tribunal, June 12, 2008) the Tribunal held that the audit methodology used in the earlier audit of petitioner was without rational basis and was unreasonable. As a result of the Tribunal's decision, and because the Division had used this same methodology in the audit for the period September 1, 2004 through May 31, 2007, the Division sent a letter to Mr. Abbasi, as president of petitioner, stating that the amount claimed to be due in the Notice of Determination had been canceled. The letter was dated October 17, 2008.

4. On October 21, 2008, the Division sent a letter to petitioner stating that the business's sales and use tax records had been scheduled for a field audit for the period December 1, 2005 through August 31, 2008. The letter stated that "[a]ll books and records pertaining to the sales and use tax liability, for the audit period, must be available on the appointment date." The appointment date indicated on the letter was November 7, 2008. A schedule of books and records to be produced was attached to the letter. The letter specifically requested among other

records, the general ledger, sales invoices, cash register tapes and bank statements for the entire audit period. No records were provided by petitioner.

On November 3, 2008, the Division sent a second letter to petitioner stating that the business's sales and use tax records had been scheduled for a field audit for the period December 1, 2005 through August 31, 2008. The letter stated that "[a]ll books and records pertaining to the sales and use tax liability, for the audit period, must be available on the appointment date." The appointment date indicated on the letter was November 24, 2008. A schedule of books and records to be produced was attached to the letter. The letter specifically requested among other records, the general ledger, sales invoices, cash register tapes and bank statements for the entire audit period. No records were provided by petitioner.

On November 24, 2008, another request letter was issued by the Division to petitioner for the business's books and records. The letter noted that Tax Law § 1135 provided that a taxpayer's records "shall be available for inspection and examination at any time upon demand by the tax commission or its duly authorized agent or employee . . . ." Again, no records were provided by petitioner.

On December 29, 2008, the Division issued to Mr. Abbasi, as president of petitioner, a subpoena and subpoena duces tecum demanding the books and records of the business. Again, no records were provided by petitioner.

5. The Division concluded that in the absence of any records being produced in response to its requests, petitioner's records were inadequate for the purpose of verifying its tax liability with respect to sales. The Division determined that the lack of original source documents detailing petitioner's sales precluded the Division from tracing any transaction back to the initial sale or forward to the amount of sales reported. In the face of a total lack of records, the auditor

decided to employ an indirect audit method to calculate the amount of taxable sales. The indirect audit method chosen was a rent factor.

6. The auditor employed an industry index entitled Almanac of Business and Industrial Financial Ratios, 2005 edition, to compute the gross sales of petitioner. The publication contains North American Industry Classification System (NAICS) data covering North America and Mexico based on Internal Revenue Service tax return information from 5 million U.S. and international corporations. The index is based on financial and operating data for the accounting period July 2001 through June 2002. The Almanac categorizes performance results on the basis of 192 industries, with each industry further divided by 13 asset size groups, beginning with zero assets. In addition, the publication provides 50 items of data and ratios on corporate performance, including an analysis of operating costs, such as rent, to operating income. In its introduction, the Almanac states, in part, as follows:

> The Almanac of Business and Industrial Financial Ratios provides a precise benchmark for evaluating an individual company's financial performance. The performance data is derived from the latest available IRS figures on U.S. and international companies, and tracks 50 operating and financial factors in 192 industries. The Almanac provides competitive norms in actual dollar amounts for revenue and capital factors, as well as important average operating costs in percent of net sales. It also provides other critical financial factors in percentage, including debt ratio, return on assets, return on equity, profit margin, and more.

7. The auditor began by most closely matching the business activity code number (453990) appearing on petitioner's U.S. Income Tax Return for an S Corporation, form 1120S, for the years 2005, 2006 and 2007 with the NAICS codes contained in the Almanac. The auditor chose the code "453000" (industry classification of miscellaneous store retailer) and the asset column of zero. The auditor surmised that as petitioner's assets were $66,033.00 in 2005, $73,791.00 in 2006 and $58,812.00 in 2007, the zero asset column was closer to petitioner's

asset valuation than the next asset column of $500,000.00. The auditor used the information in the Almanac to compute a rent factor of 7.24 percent.

8. The auditor next determined a monthly rent by using the annual rent claimed on petitioner's form 1120S income tax returns for the years 2006 and 2007. The 2006 yearly rent of $123,148.00 yielded a monthly rent of $10,262.34 and the 2007 yearly rent yielded a monthly rent of $10,232.67. The 2006 figure was used in the months of December 2005 through December 2006 and the 2007 figure was used in the months of January 2007 through August 2008. Total rent paid for the audit period was multiplied by the rent factor of 7.24 percent to arrive at audited taxable sales for the audit period of $2,447,582.00. Taxable sales reported of $800,081.00 were subtracted from audited taxable sales to determine additional taxable sales of $1,647,501.00, and additional tax due of $142,509.53 for the audit period. Penalties and statutory interest were imposed.

9. On the basis of the audit performed, the Division issued three notices of determination (Assessment #s L-031578246, L-031942506 and L-032412720), dated February 23, 2009, May 15, 2009 and August 17, 2009, respectively, to petitioner, which together assessed sales and use tax for the period December 1, 2005 through August 31, 2008 in the amount of $142,509.53, plus penalty and interest. The penalty was imposed pursuant to Tax Law § 1145(a)(1) because of the inadequacy of the business's records and the amount of the underreporting of tax.

CONCLUSIONS OF LAW

A. Tax Law § 1135(a)(1) provides that "[e]very person required to collect tax shall keep records of every sale . . . and of all amounts paid, charged or due thereon and of the tax payable thereon, in such form as the commissioner of taxation and finance may by regulation require." Such records include a "copy of each sales slip, invoice, receipt, statement or memorandum upon

which subdivision (a) of section eleven hundred thirty-two requires that the tax be stated separately." (***Id.***; 20 NYCRR 533.2[b][1].)

B. Tax Law § 1138(a)(1) provides, in relevant part, that if a sales tax return is not filed, "or if a return when filed is incorrect or insufficient, the amount of tax due shall be determined by the [Division of Taxation] from such information as may be available. If necessary, the tax may be estimated on the basis of external indices . . ." (Tax Law § 1138[a][1]). When acting pursuant to section 1138(a)(1), the Division is required to select an audit methodology reasonably calculated to reflect the tax due. The burden then rests upon the taxpayer to demonstrate that the audit methodology or the amount of the assessment was erroneous (***see Matter of Your Own Choice, Inc.***, Tax Appeals Tribunal, February 20, 2003).

C. The standard for reviewing a sales tax audit where an indirect audit methodology has been employed in the determination of sales tax liability is well established, and was set forth in ***Matter of AGDN, Inc***. (Tax Appeals Tribunal, February 6, 1997), as follows:

> a vendor . . . is required to maintain complete, adequate and accurate books and records regarding its sales tax liability and, upon request, to make the same available for audit by the Division (***see***, Tax Law §§ 1138[a]; 1135; 1142[5]; ***see, e.g.***, ***Matter of Mera Delicatessen***, Tax Appeals Tribunal, November 2, 1989). Specifically, such records required to be maintained 'shall include a true copy of each sales slip, invoice, receipt, statement or memorandum' (Tax Law § 1135). It is equally well established that where insufficient records are kept and it is not possible to conduct a complete audit, 'the amount of tax due shall be determined by the commissioner of taxation and finance from such information as may be available. If necessary, the tax may be estimated on the basis of external indices . . .' (Tax Law § 1138[a]; ***see, Matter of Chartair, Inc. v. State Tax Commn.***, 65 AD2d 44, 411 NYS2d 41, 43). When estimating sales tax due, the Division need only adopt an audit method reasonably calculated to determine the amount of tax due (***Matter of Grant Co. v. Joseph***, 2 NY2d 196, 159 NYS2d 150, ***cert denied*** 355 US 869); exactness is not required (***Matter of Meyer v. State Tax Commn***., 61 AD2d 223, 402 NYS2d 74, ***lv denied*** 44 NY2d 645, 406 NYS2d 1025; ***Matter of Markowitz v. State Tax Commn.***, 54 AD2d 1023, 388 NYS2d 176, ***affd*** 44 NY2d 684, 405 NYS2d 454). The burden is then on the taxpayer to demonstrate, by clear and convincing evidence, that the audit method employed or the tax

assessed was unreasonable (***Matter of Meskouris Bros. v. Chu***, 139 AD2d 813, 526 NYS2d 679; ***Matter of Surface Line Operators Fraternal Org. v. Tully***, 85 AD2d 858, 446 NYS2d 451).

D. In this case, the record establishes the Division's clear and unequivocal written request for books and records of petitioner's sales, as well as petitioner's failure to produce such books and records. Based on the total lack of records provided, the Division reasonably concluded that petitioner did not maintain or have available books and records that were sufficient to verify gross and taxable sales for the audit period including, most tellingly, any records of sales. Having established the unavailability of required books and records, the Division was clearly entitled to resort to the use of indirect methods, including the use of a rent factor, to determine petitioner's sales and sales tax liability. In fact, the Division's authority to do so has been consistently sustained (***see Matter of Del's Mini Deli, Inc. v. Commissioner of Taxation and Finance***, 205 AD2d 989, 613 NYS2d 967 [1994]; ***Matter of Vebole Edibles v. Tax Appeals Tribunal***, 162 AD2d 765, 557 NYS2d 678 [1990]; ***Matter of Sarantopoulos v. Tax Appeals Tribunal***, 186 AD2d 878, 589 NYS2d 102 [1992]) and the use of a rent factor has been specifically addressed and approved (***see Matter of Constantini***, Tax Appeals Tribunal, January 10, 2008; ***Matter of Your Own Choice, Inc.***, Tax Appeals Tribunal, February 20, 2003; ***Matter of Bitable on Broadway, Inc.***, Tax Appeals Tribunal, January 23, 1992, ***confirmed*** 199 AD2d 633 [1993]).

E. The rent factor, or the method by which occupancy costs are used to estimate a taxpayer's gross sales, is a method that has been considered by the Tax Appeals Tribunal. In ***Matter of Bitable on Broadway, Inc.***, the Tribunal approved the use of a rent factor in the absence of adequate records. In that case, the Division used a rent factor obtained from the National Restaurant Association's Restaurant Industry Operations Report for 1987. In approving

the use of the rent factor, the Tribunal concluded that it was sufficient for the Division to identify the statistical report on which its calculations were based since the report was publicly available and the taxpayer would thus be able to introduce evidence challenging the soundness or applicability of the report. The decision specifically distinguishes "those cases where the audit methodology is based on facts that are peculiarly within the knowledge of the Division, e.g., audits of similar establishments, where the Division has the obligation to describe these facts in response to the petitioner's inquiries at hearing" (***id.,*** citing ***Matter of Basileo***, Tax Appeals Tribunal, May 9, 1991; ***see also Matter of Abbasi***, Tax Appeals Tribunal, June 12, 2008). Here, the Division not only identified and introduced into the record the statistical report on which its calculations were based, but described and responded to petitioner's inquiries at hearing as to how the Almanac was used in the audit of petitioner. In view of the foregoing, the only questions presented in this case are whether petitioner has established that the audit method employed was unreasonable and whether the amount of tax assessed as the result of the application of the method used in this case was erroneous (***Matter of Surface Line Operators Fraternal Organization v. Tully***).

F. Petitioner has not established that the audit method was unreasonable or that the amount of tax determined by application of such method was erroneous. For the period in question, petitioner did not maintain any records of sales as required by the Tax Law. Petitioner presented no invoices, cash register tapes, guest checks or other source documentation that could be used to establish the correct amount of sales tax due. Having established the inadequacies of a taxpayer's records, the Division is under no obligation to utilize one indirect method of audit as opposed to another, but rather must only select a method of audit reasonably calculated to determine the amount of tax due (***Matter of Grant Co. v. Joseph***). Petitioner presented no

evidence to show that the rent factor utilized by the Division was unreasonable. Under these circumstances, the Division's resort to a rent factor to determine sales for the audit period was entirely reasonable (***cf. Matter of Fokos Lounge, Inc.***, Tax Appeals Tribunal, March 7, 1991 [where taxpayer proved through an expert witness that the utilities factor was without a rational basis as applied to its business]). Furthermore, as a general proposition, any imprecision in the results of an audit arising by reason of a taxpayer's own failure to keep and maintain records of all of its sales as required by Tax Law § 1135(a)(1) must be borne by that taxpayer (***Matter of Markowitz v. State Tax Commission***; ***Matter of Meyer v. State Tax Commission***).

G. Petitioner's claim that the Division may not issue a notice of determination following the cancellation of a previously issued notice of determination covering the same period is unpersuasive. Tax Law § 1138(a)(1) provides that the Division may issue a notice of determination to a person or persons liable for the collection or payment of the tax where a sales tax return is not filed or where a return when filed is incorrect or insufficient. Tax Law § 1147(b) states that no assessment of additional tax shall be made after three years from the date of the filing of a return. Each of the notices of determination at issue were issued by the Division within three years of the filing of the sales tax returns relating to the quarters at issue. As the notices were issued within the statute of limitations provided by Tax Law § 1147(b), they were properly issued pursuant to Tax Law § 1138(a)(1).

H. In establishing reasonable cause for the abatement of penalty, the taxpayer faces an onerous task (***Matter of Philip Morris, Inc.***, Tax Appeals Tribunal, April 29, 1993). In ***Philip Morris*** it was explained that "[b]y first requiring the imposition of penalties (rather than merely allowing them at the Commissioner's discretion), the Legislature evidenced its intent that filing returns and paying the tax according to a particular timetable be treated as a largely unavoidable

obligation [citations omitted]" (***Matter of MCI Telecommunications Corp.***, Tax Appeals Tribunal, January 16, 1992, ***confirmed*** 193 AD2d 978, 598 NYS2d 360 [1993]). Here, petitioner failed to make adequate books and records available for audit and substantially underreported and underpaid the tax due. Under these circumstances, the waiver of penalties is not justified.

I. The petition of New Intrigue Jewelers, Inc. is denied, and the notices of determination dated February 23, 2009, May 15, 2009 and August 17, 2009 are sustained, together with such penalties and interest as may be lawfully due.

DATED: Albany, New York
October 25, 2012

/s/ Thomas C. Sacca
ADMINISTRATIVE LAW JUDGE